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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

The Fed Tightens Up

The announcement of a larger-than-expected 283,000 person increase in nonfarm payroll employment in July, a substantial upward revision to the June employment numbers, and an acceleration in wage growth apparently provided sufficient ammunition last week for the Federal Reserve to overtly firm monetary policy. With the labor markets seemingly tightening and industry operating rates edging higher, the Fed boosted its discount rate by one half of one percentage point from six to 6½ percent, the first time this key rate was raised since last September. Major banks followed by boosting their prime lending rates a half-point to 10 percent—the highest since June 1985.

In taking this step, the central bank is attempting to slow the growth of the economy with the intent of pre-empting budding price pressures. However, since this action comes at a time when domestic demand has already softened and inflation pressures remain restrained, this latest turn of the monetary screws may well be the culmination of a series of incremental tightening steps, rather than the beginning of a new round of monetary policy restraint.

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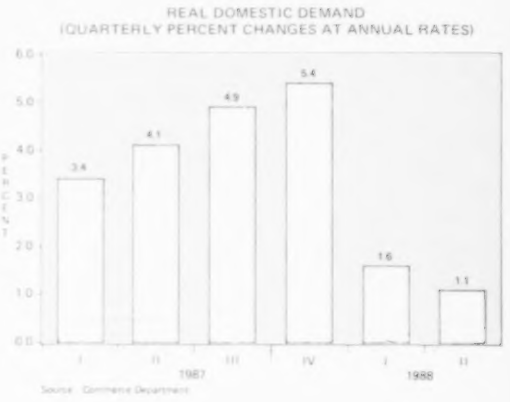
At first glance, it is hard to believe that there are any soft spots in the economy and that inflation pressures are moderate. After all, with total employment surging in the past two months, the economy's forward momentum appeared to be strong, going into the third quarter. Brisk increases in manufacturing employment, accompanied by a longer factory workweek, suggest that good-sized increases in industrial production and capacity utilization rates almost certainly occurred last month. In fact, the July employment numbers appeared so robust that some analysts are now speculating that the economy is expanding at a full percentage point faster clip than it did in the second quarter, when the inflation adjusted GNP rose at a healthy 3.1 percent annual rate. According to this view, higher levels of economic activity mean escalating wages and greater capacity constraints—the classic recipe for higher inflation rates and even more monetary restraint.

A Well-Balanced Business Expansion

The problem with this line of reasoning is that it overlooks the benefits arising from the sweeping shift in the composition of economic growth which has occurred in recent quarters, a change which could well be muting, rather than enhancing price pressures. The largest single contributor to growth over the past two quarters has been the narrowing of the foreign trade deficit.



All this has taken place against the backdrop of a decided slowing of much of the rest of the economy, preserving today's relatively stable price environment and allowing room for the export/capital spending surge. For, as shown in the chart, the growth of real domestic demand, or real GNP minus the foreign trade sector, has decelerated sharply this year, as consumer spending softened, housing activity flattened and government demand tapered-off.

So, too, this compositional shift in growth casts doubt on the assumption of the inflation bears that more jobs and higher wages necessarily threaten price stability. For one thing, a good chunk of the job gains of recent months are related to the capital spending surge, as well as to the production of more goods for export. For another, the rise in payroll employment has shown no sign of fueling a bulge in household spending. Consumer spending on goods, after accounting for inflation, is no higher today than it was two years ago. Although the reasons for the loose linkage between the

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rapid growth of payroll jobs and the flattening of household spending are being hotly debated, it could be partially due to the double-counting of multiple job holders who are trying to make ends meet, and/or the attempt by households in general to rebuild much depleted savings balances.

Few Signs Of Inflation

Far from being inflationary, today's robust export and associated capital spending led growth may be quite the opposite, setting the stage for modest rates of inflation for years to come. Perhaps for this reason, despite all the dire inflation predictions, there are actually very few signs of a price surge (Financial Digest–August 1, 1988). The consumer price index continues to edge up at a moderate pace, the rise of commodity prices seems to have topped out, oil prices are drifting lower and the price of gold is falling. Even the bug-a-boo of higher industry operating rates and its inflationary implications has been exaggerated. While the overall capacity utilization rate has been creeping higher, the most pronounced gains are occuring in such industries as autos and machinery, which still possess large chunks of idle

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/27/88)	186,706	+ 2,023	+ 15,136
New York City (8/3/88)	38,882	+ 131	+ 1,495
Commercial Paper (8/3/88)	416,682	– 1,356	+ 71,332

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/27/88)	299,422	– 98	+22,176
New York City (8/388)	57,719	– 171	+ 1,181

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/27/88)	891,477	– 848	+65,261
New York City (8/3/88)	175,360	+ 389	–27,564

Financial Markets

	Friday 8/12/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.21%	+ .11	+ 1.10
180-Day Bills†	7.83	+ .23	+ 1.54
Longest Bills†	8.22	+ .21	+ 1.38
Recent Issues:			
83/8S 7/31/90	8.64	+ .20	
81/4S 6/30/92	8.67	+ .23	
91/4S 8/10/98	9.50	NA	
91/8S 5/15/18	9.40	+ .27	
Municipals:			
Bond Buyer–20 Bond Index* (8/11/88)	7.83%	+ .14	+ .07
Blue List Total ($ Million)	$1,315	– $ 9	–$ 219
30-Day Visible Supply ($ Million)	$1,899	+ $ 323	–$ 899
Total	$3,214	+ $ 314	–$1,118
Corporates:			
Moody's Aa Composite (8/11/88)	10.37%	+ .11	+ .52
30-Day Visible Supply ($ Million)	$4,367	+ $1,638	+$1,809
Stocks:			
Dow-Jones Averages:			
Industrials	2,037.52	– 81.61	–647.91
Transportation	852.15	– 29.12	–249.01
Utilities	176.68	– 5.99	– 37.11
65 Stocks	762.41	– 28.58	–226.67
N.Y.S.E. Composite Index	148.55	– 4.54	– 38.14
N.Y.S.E. Avg. Daily Vol. for Week (000's)	180,352	+ 24,280	–42,659

*34% Taxable equivalent 11.86%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 8/12/88	Week Ago
Overnight	8.00%	7.50%
1 month	8.31	7.94
3 month	8.63	8.25
6 month	8.88	8.56
1 year	9.13	8.75

FOREIGN EXCHANGE SPOT RATES

New York Opening (8/12/88)	Currency Per U.S. $	Week Ago
Belgium	39.42	39.47
Canada	1.2228	1.2061
France	6.3730	6.3640
Germany	1.8792	1.8875
Italy	1395.00	1392.00
Japan	133.00	133.36
Mexico	2273.00	2273.00
Netherlands	2.1270	2.1293
South Korea	723.20	723.30
Switzerland	1.5760	1.5825
Taiwan	28.62	28.63
U.K.*	1.7130	1.7035

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (8/12/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.4%	–1.2%

capacity, while such industries as paper and textiles, which had been operating near full capacity, have experienced a dip in capacity usage.

Why, then, in light of all this, did the Fed choose now to overtly tighten the monetary reins—and right in the middle of a quarterly Treasury refunding operation to boot? The Treasury auctions may provide part of the reason; speculation had been rampant for weeks regarding a Fed tightening, and the hike in the discount rate removed some of the uncertainty among potential bidders.

Also, the Fed needed to convince the bond market bears that policy flexibility will not be held hostage to the upcoming Presidential elections. Unwittingly, however, the Fed may have exchanged one potential policy straightjacket for another. For if it allows policy to be even subtly guided by the fleeting shifts in bond market psychology, the policy rollercoaster is just about to begin; the consensus in the fixed-income markets changes almost as often as a summer movie marquee. For this reason, the Fed must always lead the bond crowd, rather than the reverse. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 8/10/88	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	230.307	– 1.190	+16.008
Loans to Depository Inst.	3.176	– .326	+ 2.605
Float	.680	– .148	+ .229
Total Reserve Bank Credit	251.666	– .915	+20.134
Treasury Deposits with Federal Reserve Banks	3.158	– .252	+ .052
Currency in Circulation	236.507	+ 1.204	+19.225
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	224.069	– .161	+47.579
	8/10/88		
Member Bank Reserves:			
Total Reserves Held	60.807	– .229	+ 3.439
Excess (Deficiency)	.715	– .515	– .086
Net Excess Reserves	.124	– .501	– .233
Monetary Aggregates †		‡ % Change Since 3 Months Ago*	% Change Since Year Ago
M1 (8/1/88)	784.4	+ 6.1	+ 5.3
M2 (8/1/88)	3,027.7	+ 4.2	+ 5.7
M3 (8/1/88)	3,823.3	+ 5.5	+ 6.3
Domestic Nonfinancial Debt (1st Q'88)	8,541.7	+ 8.2	+ 9.3

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 8/12/88	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.00%	7.45%	7.66%
* Federal Agencies	8.10	8.10	8.10
* Municipal Notes—High Grade (34% Taxable Equivalent)	8.71	9.09	9.09
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	8.35	8.70	8.95

‡ Finance Company Paper—Prime

5- 14 days	8.00%
15- 29 days	8.08
30- 59 days	8.15
60- 89 days	8.15
90-179 days	8.05
180-239 days	7.90
240-270 days	7.90

‡* Bankers' Acceptances

Sep.	8.08%
Oct.	8.18
Nov.	8.25
Dec.	8.30
Jan.	8.38
Feb.	8.38

‡ Industrial Paper—Prime

30- 89 days	8.25%
90-120 days	8.38

† Federal Funds Effective Rate 8.20%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'88	$ 4,807	$ 4,725	$ 4,484
Gross National Product (1982 Dollars)*	2nd Q'88	$ 3,986	$ 3,956	$ 3,823
Percent Change, Annual Rate	2nd Q'88	3.1	3.4	5.0
Change in Consumer Prices*	Jun '88	3.6%	3%	3.6%
Change in MH Cost of Living Index	Jun '88	4.8%	3%	3.6%
Change in Producer Prices*	Jul '88n	6.0%	3%	1.2%
Civilian Employment (Thousands of Persons) †	Jul '88	115,059		112,639
Unemployment as % of Civilian Labor Force †	Jul '88	5.4%	%	6.0%
Personal Income*	Jun '88	$ 4,042	$	$ 3,747
Leading Indicators Composite Index (1967=100) †	Jun '88n	194.0	191.3r	190.5
Industrial Production Index (1977=100) †	Jun '88	136.6	136.1	129.1
Net Change in Consumer Installment Credit †	Jun '88n	$ 5.43	$ 2.98r	$ 6.65
U.S. Merchandise Trade Balance †	May '88	–$ 10.93	–$ 10.30	–$ 14.07
Plant and Equipment Expenditures*	3rd Q'88	$438.22(a)	$429.01(a)	$393.13
Private Housing Starts (Thousands of Units)*	Jun '88	1,454r	1,384r	1,583r
New Construction Expenditures*	Jun '88n	$ 402.8	$ 402.3r	$ 392.6
Total Business Inventories †	Jun '88n	$ 733.9	$ 729.0r	$ 680.5r
Total Business Sales †	Jun '88B	$ 490.6	$ 483.6r	$ 453.9r

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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Advisor

Merger & Acquisition Expertise

EAC USA
U.S. subsidiary of
EAC, Inc.
has acquired
Baumfolder, Inc.

Manufacturers Hanover Trust Company acted as exclusive advisor to EAC USA in this transaction and assisted in the negotiations.

Ellesse USA Inc.
a subsidiary of
Ellesse Int'l. S.p.A.
has been sold to
Reebok International Ltd.

Manufacturers Hanover Trust Company acted as exclusive financial advisor to Ellesse Int'l. S.p.A. in this transaction.

PRC Management, Inc.
has acquired
Metropolitan Savings Association

Manufacturers Hanover Trust Company initiated this transaction and acted as exclusive advisor to PRC Management.

Soros Associates
has been acquired by
Snamprogetti USA Inc.
a subsidiary of
Snamprogetti S.p.A. and ENI Group

Manufacturers Hanover Trust Company acted as exclusive advisor to Soros Associates and assisted in the negotiations.

Brown Jordan Furniture
a subsidiary of
Brown Jordan Company Limited Partnership
a partnership organized by
Integrated Resources
has been sold to
Chicago Pacific Corp.

Manufacturers Hanover Trust Company acted as exclusive financial advisor to Integrated Resources and Brown Jordan Company Limited Partnership in this transaction.

American Lantern
a subsidiary of
Brown Jordan Company Limited Partnership
a partnership organized by
Integrated Resources
has been sold to
First Chicago Venture Capital Corp.

Manufacturers Hanover Trust Company acted as exclusive financial advisor to Integrated Resources and Brown Jordan Company Limited Partnership in this transaction.

The Investment Banking Group

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